

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

FEDERAL TRADE COMMISSION,

Plaintiff,

vs.

NEOVI, INC., et al.,

Defendant.

CASE NO. 06-CV-1952 JLS (JMA)

**ORDER: DENYING
DEFENDANTS' MOTION TO
LIMIT THE SCOPE OF THE
SHOW CAUSE HEARING**

(Doc. No. 187)

Presently before the Court is Defendants' motion to limit the scope of the show cause hearing regarding contempt. (Doc. No. 187.) For the following reasons, the Court **DENIES** Defendants' motion.

BACKGROUND

The parties in this case are well aware of the background of this matter. Moreover, this Court and the Ninth Circuit have both provided a full description of the underlying facts. (*See* Doc. No. 105 (MSJ Order), at 2–8; *FTC v. Neovi, Inc.*, — F.3d —, 2010 WL 2362956, at *1–3 (9th Cir. June 15, 2010).) Those factual summaries are incorporated by reference here. However, this Order will describe the procedural history relevant to the instant motion.

On September 16, 2008, the Court granted Plaintiff's motion for summary judgment, finding that Defendants' Qchex system violated section 5 of the FTC Act, 15 U.S.C. § 45(n). (Doc. No. 105.) On January 7, 2009, the Court denied Defendants' motion for reconsideration (Doc. No. 117) and

1 entered a permanent injunction enjoining Defendants from “creating¹ or delivering² any check for a
 2 customer” without performing identity verification of prospective customers and account control
 3 verification (Doc. No. 118 (Final Order), at 4–5.) Defendants timely appealed. (Doc. No. 119.)

4 While Defendants’ appeal was pending before the Ninth Circuit, Plaintiff moved for an order
 5 to show cause why Defendants should not be held in contempt. (Doc. No. 156 (Contempt Motion).)
 6 Plaintiff based its Contempt Motion on Defendants’ “continuing operation of
 7 FreeQuickWire.com . . . , an electronic check creation and delivery service nearly identical to the
 8 Qchex and GoChex services that the Court found violated Section 5 of the FTC Act” (Mem. ISO
 9 Contempt Mot. 1.) On November 13, 2009, the Court granted Plaintiff’s motion and ordered
 10 Defendants to appear and show cause why they should not be held in civil contempt for failing to
 11 comply with the terms of the Final Order. (Doc. No. 170.) On December 22, 2009, the Ninth Circuit
 12 granted Defendants’ request to expedite their appeal, and the Court vacated all dates associated with
 13 the show cause hearing pending resolution of Defendants’ appeal. (Doc. No. 177.) On May 14, 2010,
 14 the Ninth Circuit affirmed in full the Court’s Order denying Defendants’ motion for reconsideration
 15 and the Final Order. *See Neovi*, — F.3d —, 2010 WL 2362956, at *3–8. On the same day, the Court
 16 reset the show cause hearing for July 15, 2010. (Doc. No. 179.)

17 On July 2, 2010, Plaintiff filed supplemental briefing in support of its Contempt Motion. (Doc.
 18 No. 182.) Plaintiff’s supplemental briefing cites two additional products Plaintiff believes violate the
 19 Final Order: “VersaCheck® 2010 software and newly-released Qchex check creation templates.”
 20 (Supplemental Mem. ISO Contempt Mot. 1.)

21 At the July 15, 2010 show cause hearing, Defendants for the first time contended that the
 22 VersaCheck® 2010 software (VersaCheck) was not a proper subject of the contempt proceeding.
 23 (Show Cause Hr’g Tr. 10–12.) The Court invited briefing on the proper scope of the contempt
 24

25
 26 ¹ The Final Order defines *creating* as “any involvement in the creating, designing, composing,
 27 drawing, or writing on paper or electronic media a check drawn on a specific financial institution.”
 (Final Order 3.)

28 ² The Final Order defines *delivering* as “any involvement in the mailing, faxing, e-mailing,
 sending, or transmitting by any other method a check drawn on a specific financial institution.” (Final
 Order 3.)

proceeding. (*Id.* 13.) On September 23, 2010, the Court heard argument on the instant motion.³ (Doc. No. 194.)

ANALYSIS

Defendants raise two arguments in support of their position that the show cause hearing should be limited to whether the operation of FreeQuickWire.com (FQW) violates the Final Order.⁴ The Court addresses each in turn.⁵

I. Defendants Had Adequate Notice That VersaCheck Might Violate the Final Order

Defendants first contend that they did not have notice that VersaCheck might violate the Final Order because the FTC never challenged Defendants' marketing of VersaCheck, even though VersaCheck predated the FTC's enforcement action and the Final Order. (*See* Mem. ISO Mot. Re: Scope 5–6; Reply 2–3.) Plaintiff responds that Defendants' contention is without merit because the Final Order's "specific and definite language squarely applies to" VersaCheck. (Opp'n 3.) Plaintiff also argues that the Final Order properly incorporates "fencing-in" provisions that apply beyond Qchex. (*Id.* 4–6.)

A court may frame an injunction based on violation of the FTC Act broadly enough to prevent the defendant from engaging in similar illegal conduct in the future. *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 395 (1965); *see also NLRB v. Express Publ'g Co.*, 312 U.S. 426, 435 (1941) ("A federal

³ On September 10, 2010, Magistrate Judge Adler ordered Defendants to serve a disclosure for their expert witness, Dan M. Fisher, consistent with Federal Rule of Civil Procedure 26(a)(2), by September 17, 2010. (*Id.* at 2.) At the Court's direction, Magistrate Judge Adler subsequently vacated the deadline for Mr. Fisher's disclosure pending the September 23, 2010 hearing on the instant order. (Doc. No. 193.) The Court resets the deadline for Mr. Fisher's disclosure *infra*.

⁴ To be clear, the instant Order only decides the narrow issue of the scope of the contempt hearing—not the broader issue of whether Defendants' marketing of VersaCheck violates the Final Order.

⁵ As an initial matter, Defendants argue that "[the] Final Order at issue . . . [is] ambiguous," and therefore, Defendants' marketing of VersaCheck should not be considered in the contempt proceeding. (Mem. ISO Mot. Re: Scope 6.) It is well established, however, that "a contempt proceeding does not open to reconsideration the legal or factual basis of the order alleged to have been disobeyed" *United States v. Rylander*, 460 U.S. 752, 756 (1983) (quoting *Maggio v. Zeitz*, 333 U.S. 56, 69 (1948)); *cf. In re Establishment Inspection of Hern Iron Works, Inc.*, 881 F.2d 722, 725–26 (9th Cir. 1989) ("[T]he collateral bar rule permits a judicial order to be enforced through criminal contempt even though the underlying decision may be incorrect and even unconstitutional. The contemnor cannot ordinarily raise the invalidity of the judicial order as a defense to a contempt charge." (citations omitted)). Accordingly, Defendants may not challenge the validity of the Final Order in these contempt proceedings.

1 court has broad power to restrain acts which are of the same type or class as unlawful acts which the
 2 court has found to have been committed or whose commission in the future unless enjoined, may fairly
 3 be anticipated from the defendant's conduct in the past."). "[C]ourts have often upheld FTC orders
 4 encompassing all products or all products in a broad category, based on violations involving only a
 5 single product or group of products" *Sears, Roebuck & Co. v. FTC*, 676 F.2d 385, 391 (9th Cir.
 6 1982) (quoting *ITT Cont'l Baking Co. v. FTC*, 532 F.2d 207, 223 (2d Cir. 1976)) (alterations in
 7 original); *cf. Int'l Rectifier Corp. v. IXYS Corp.*, 383 F.3d 1312, 1318 (9th Cir. 2004) (declining to
 8 hold that contempt proceeding should be unavailable with respect to pre-judgment devices not accused
 9 of infringement in the underlying action). Thus, "those caught violating the [FTC] Act must expect
 10 some fencing in." *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 431 (1957).

11 Here, the Court's Order granting Plaintiff's proposed injunctive relief explicitly contemplated
 12 that the Final Order would apply beyond Qchex. (*See* Doc. No. 117, at 13 ("Defendants' pattern of
 13 conduct demonstrates a significant disregard for check fraud and a significant likelihood of future
 14 violation. . . . [F]ollowing the bankruptcy of Qchex, Defendants opened two more businesses offering
 15 the same basic functionality. Given the seriousness and deliberateness of Defendants' past record of
 16 violations, injunctive relief is appropriate." (citation omitted)).) And although Defendants purport to
 17 interpret the Final Order as narrowly applying to "a discrete line of G7's products," (Reply 4) the Final
 18 Order is clearly broader—it enjoins Defendants "from creating or delivering *any* check for a
 19 customer" (Final Order 4). Thus, to the extent that VersaCheck incorporates check creation and
 20 delivery functions, Defendants were on notice that Plaintiff might take the position that Defendants'
 21 continued marketing of VersaCheck violates the Final Order. Defendants cannot now seek to limit
 22 the scope of the show cause hearing because they failed to "expect some fencing in." *Nat'l Lead*, 352
 23 U.S. at 431.

24 **II. Plaintiff Should Not Be Estopped from Presenting Evidence of Contempt Based on** 25 **Defendants' Marketing of VersaCheck**

26 Defendants next contend that Plaintiff should be estopped from presenting evidence of
 27 Defendants' marketing of VersaCheck in support of Plaintiff's contempt allegations. (*See* Reply 5–7.)
 28 Plaintiff responds that Defendants cannot establish the requisite elements for estoppel against the

1 government. (Opp’n 6–9.)

2 A party seeking to establish estoppel against the government must first demonstrate that the
3 four requirements of equitable estoppel are met. *United States v. Gamboa-Cardenas*, 508 F.3d 491,
4 502 (9th Cir. 2007). “Those elements are ‘(1) the party to be estopped knows the facts, (2) he or she
5 intends that his or her conduct will be acted on or must so act that the party invoking estoppel has a
6 right to believe it is so intended, (3) the party invoking estoppel must be ignorant of the true facts, and
7 (4) he or she must detrimentally rely on the former’s conduct.’” *Id.* (quoting *United States v. Hemmen*,
8 51 F.3d 883, 892 (9th Cir. 1995)). In addition, a party seeking to estop the government must establish
9 that (1) “the government has engaged in affirmative misconduct going beyond mere negligence” and
10 (2) “the government’s act will cause a serious injustice and the imposition of estoppel will not unduly
11 harm the public interest.” *Gamboa-Cardenas*, 508 F.3d at 502 (quoting *Pauly v. USDA*, 348 F.3d
12 1143, 1149 (9th Cir. 2003)) (internal quotation marks omitted).

13 “Affirmative misconduct requires an affirmative misrepresentation or affirmative concealment
14 of a material fact by the government.” *Carrillo v. United States*, 5 F.3d 1302, 1306 (9th Cir. 1993).
15 “[M]ere unexplained delay” does not amount to affirmative misconduct. *Jaa v. INS*, 779 F.2d 569,
16 572 (9th Cir. 1986); *see also Santamaria-Ames v. INS*, 104 F.3d 104 F.3d 1127, 1133 (9th Cir. 1996)
17 (citing *INS v. Miranda*, 459 U.S. 14, 18–19 (1982)).

18 Here, Defendants’ estoppel claim must fail. Defendants have given the Court no reason to
19 believe that Plaintiff’s delay in identifying VersaCheck as illegal resulted from “affirmative
20 misconduct going beyond mere negligence” *Gamboa-Cardenas*, 508 F.3d at 502. Plaintiff’s
21 “mere unexplained delay” in asserting that Defendants’ marketing of Qchex violates the Final Order
22 is insufficient to establish the affirmative misconduct required for estoppel against the government.
23 *Jaa*, 779 F.2d at 572. And the Court’s order granting Plaintiff’s proposed injunctive relief, which
24 explicitly contemplated that the Final Order would apply beyond Qchex, undermines Defendants’
25 claim that Plaintiff affirmatively misrepresented the scope of its investigation as limited to Qchex.
26 (*See* Doc. No. 117, at 13.)

27 CONCLUSION

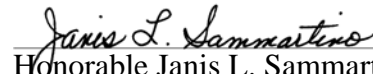
28 For the reasons stated, Defendants’ motion to limit the scope of the show cause hearing is

1 **DENIED.** At the show cause hearing, Plaintiff may present its case as to why Defendants' marketing
2 of VersaCheck violates the Final Order. No later than October 18, 2010:

- 3 (1) Defendants **SHALL SERVE** Plaintiff with a disclosure for their expert witness, Mr.
4 Fisher, consistent with the requirements of Federal Rule of Civil Procedure 26(a)(2);
5 and
6 (2) The parties **SHALL EXCHANGE** lists of exhibits and witnesses to be offered at the
7 show cause hearing.

8 IT IS SO ORDERED.

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10 DATED: September 27, 2010

11 
12 Honorable Janis L. Sammartino
13 United States District Judge
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